

**Palo Alto County Hospital
d/b/a
Palo Alto County
Health System**

**PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM**

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PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
BOARD OF TRUSTEES AND HEALTH SYSTEM OFFICIALS
JUNE 30, 2006 AND 2005

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
James Hobart	Chair	December 31, 2010
Charles S. Wirtz	Treasurer	December 31, 2006
Gary Hughes	Secretary	December 31, 2008
Mick Conway	Member	December 31, 2010
Tom Magee	Member	December 31, 2006
Ken Kassel	Member	December 31, 2006
Shirley Kruse	Member	December 31, 2008

Health System Officials

Thomas J. Lee	Chief Executive Officer
Renay Hauswirth	Director of Finance



INDEPENDENT AUDITOR'S REPORT

The Board of Trustees
Palo Alto County Hospital
d/b/a Palo Alto County Health System
Emmetsburg, Iowa

We have audited the accompanying financial statements of **Palo Alto County Hospital d/b/a Palo Alto County Health System** for the year ended June 30, 2006, and its **discretely presented component unit** for the year ended December 31, 2005 as listed in the table of contents. These financial statements are the responsibility of the Health System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of **Palo Alto County Hospital, d/b/a Palo Alto County Health System** for the year ended June 30, 2005 and its **discretely presented component unit** for the year ended December 31, 2004, were audited by other auditors whose report dated September 29, 2005, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2006 financial statements referred to above present fairly, in all material respects, the financial position of **Palo Alto County Hospital, d/b/a Palo Alto County Health System** and the 2005 financial statements for its **discretely presented component unit**, as of June 30, 2006 and December 31, 2005, and the respective changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As indicated in the Health System's Summary of Significant Accounting Policies in Note 1 to the financial statements, management has elected to report interest expense as an operating expense in the Statement of Revenues, Expenses and Changes in Net Assets. *Governmental Auditing Standards Board Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* does not establish a definition of operating revenues and expenses versus nonoperating revenues and expenses. Rather, governments are required to establish their own policy defining operating revenues and expenses and apply the policy consistently. The common practice for governmental health care entities is to include interest expense in nonoperating revenues and expenses.

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In accordance with *Government Auditing Standards*, we have also issued our report dated July 20, 2006, on our consideration of **Palo Alto County Hospital, d/b/a Palo Alto County Health System**, internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 4 through 11 and the Budgetary Comparison Schedules on page 32 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion on it.

A handwritten signature in cursive script that reads "Erik Saully LLP". The signature is written in dark ink and is positioned above the printed text of the firm's name and location.

Minneapolis, Minnesota
July 20, 2006

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2006 AND 2005

This section of the Palo Alto County Health System's annual audited financial report represents management's discussion and analysis of the Health System's financial performance during the fiscal year ended June 30, 2006. The analysis will focus on the Health System's financial performance as a whole. Please read it in conjunction with the audited financial report.

Using This Annual Report

The June 30, 2006 and 2005 financial report includes the following audited financial statements:

- Balance Sheets
- Statements of Revenues, Expenses, and Changes in Net Assets
- Statements of Cash Flows
- Notes to Financial Statements

Financial Highlights

- The Health System's total assets increased by \$422,192 or 1.8% in 2006 and increased by \$2,208,210 or 10.3% in 2005.
- The Health System's net assets increased by \$699,400 or 5.0% in 2006 and increased in 2005 by \$1,464,857 or 11.8%.
- The Health System reported an operating gain of \$79,933 in 2006 and an operating gain of \$245,735 in 2005. This represents a decrease in 2006 of \$165,802 and an increase in 2005 of \$1,020,152.

The Balance Sheet and Statement of Revenues, Expenses, and Changes in Net Assets

These financial statements report information about the Health System using Governmental Accounting Standards Board (GASB) accounting principles. The balance sheet is a statement of financial position. It includes all of the Health System's assets and liabilities and provides information about the amounts of investments in resources (assets) and the obligations to Health System creditors (liabilities). Revenues and expenses are reflected for the current and previous year on the Statements of Revenues, Expenses, and Changes in Net Assets. This statement shows the results of the Health System's operations. The last financial statement is the Statements of Cash Flows. The cash flow essentially reflects the movement of money in and out of the organization that determines the Health System's solvency. It is divided into cash flows (in or out) from operating, noncapital financing, capital and related financing, and investing activities.

Required supplementary information to the above statements is provided in:

- Budgetary Comparison Schedule of Revenues, Expenses and Changes in Net Assets

Other supplementary information to the above statements is provided in:

- Schedules of Net Patient and Resident Service Revenue
- Schedules of Adjustments to Patient and Resident Service Revenue and Other Revenues
- Schedules of Operating Expenses
- Schedules of Patients' and Residents' Receivables and Allowance for Doubtful Accounts
- Schedule of Supplies and Prepaid Expenses
- Schedule of Comparative Statistics

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS – PAGE 2
YEARS ENDED JUNE 30, 2006 AND 2005

Financial Analysis of the Health System

The information from the Balance Sheets, Statements of Revenues, Expenses, and Changes in Net Assets, and the Statements of Cash Flows have been summarized in the following tables. Tables 1 and 2 report on the net assets of the Health System and the changes in them. Increases or decreases in net assets are one indicator of whether or not the Health System's financial health is improving. Other non-financial factors can also have an effect on the Health System's financial position. These can include such things as changes in Medicare and Medicaid regulations and reimbursement, changes with other third-party payers, as well as changes in the economic environment of Palo Alto County and the surrounding areas.

Table 1: Assets, Liabilities, and Net Assets

	<u>2006</u>	<u>2005</u>	<u>2004</u>
ASSETS			
Current assets	\$ 8,627,333	\$ 7,034,957	\$ 4,731,949
Noncurrent assets limited as to use or restricted	4,608,840	5,672,055	5,509,791
Capital assets, net	10,604,592	10,704,361	10,954,223
Other assets	<u>159,311</u>	<u>166,511</u>	<u>173,711</u>
Total assets	<u>\$ 24,000,076</u>	<u>\$ 23,577,884</u>	<u>\$ 21,369,674</u>
LIABILITIES			
Current liabilities	\$ 3,273,709	\$ 3,387,810	\$ 2,027,671
Long-term debt (less current maturities)	6,073,078	6,241,212	6,404,346
Other liabilities	<u>23,186</u>	<u>18,159</u>	<u>19,457</u>
Total liabilities	<u>9,369,973</u>	<u>9,647,181</u>	<u>8,903,828</u>
NET ASSETS			
Invested in capital assets net of related debt	4,515,825	4,459,660	4,330,068
Restricted			
By bond agreement	783,569	1,096,128	736,540
By contributors and grantors	-	45,237	44,495
Unrestricted	<u>9,330,709</u>	<u>8,329,678</u>	<u>7,354,743</u>
Total net assets	<u>14,630,103</u>	<u>13,930,703</u>	<u>12,465,846</u>
Total liabilities and net assets	<u>\$ 24,000,076</u>	<u>\$ 23,577,884</u>	<u>\$ 21,369,674</u>

**PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS – PAGE 3
YEARS ENDED JUNE 30, 2006 AND 2005**

Asset categories changing significantly during 2006 and 2005 included cash and cash equivalents, assets limited as to use or restricted, and net capital assets. Current assets increased by \$1,592,376 or 22.6% in 2006 and increased by \$2,755,362 or 64.4% in 2005. The majority of the increase in the current year is attributed to the increase in cash and cash equivalents which is a result of operations. Assets limited as to use or restricted decreased by \$1,375,774 or 21.8% and increased in 2005 by \$795,046 or 14.4%. Capital assets decreased in 2006 by \$99,769 or .9% and decreased in 2005 by \$249,862 or 2.3%.

The current ratio (current assets divided by current liabilities) for 2006 was 2.64 and 2005 was 2.08. It is a measure of liquidity, providing an indication of the Health System's ability to pay current liabilities; a high ratio number is preferred.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS – PAGE 4
YEARS ENDED JUNE 30, 2006 AND 2005

Table 2 summarizes information from the Statements of Revenues, Expenses, and Changes in Net Assets.

Table 2: Statement of Revenues, Expenses, and Changes in Net Assets

	<u>2006</u>	<u>2005</u>	<u>2004</u>
OPERATING REVENUES			
Net patient and resident service revenue	\$ 14,384,311	\$ 13,716,417	\$ 12,017,640
Apartment revenue	359,709	364,409	357,381
Other revenue	577,684	584,627	515,814
Total operating revenues	<u>15,321,704</u>	<u>14,665,453</u>	<u>12,890,835</u>
OPERATING EXPENSES			
Salaries and wages	5,685,721	5,325,582	5,139,771
Employee benefits	1,638,007	1,397,937	1,541,209
Professional fees	2,534,763	2,525,276	2,407,699
Management, legal, and accounting fees	159,144	156,224	179,656
Utilities	258,769	233,295	213,439
Insurance	186,193	162,057	128,528
Supplies and other expenses	3,528,745	3,336,118	2,795,763
Depreciation	945,633	973,509	916,985
Interest and amortization	304,796	309,720	342,202
Total operating expenses	<u>15,241,771</u>	<u>14,419,718</u>	<u>13,665,252</u>
OPERATING INCOME (LOSS) BEFORE AFFILIATION AGREEMENT	<u>79,933</u>	<u>245,735</u>	<u>(774,417)</u>
AFFILIATION AGREEMENT EXPENSE	<u>(37,845)</u>	<u>(17,881)</u>	<u>-</u>
INCOME (LOSS) FROM OPERATIONS	<u>42,088</u>	<u>227,854</u>	<u>(774,417)</u>
Nonoperating revenues (expenses)	<u>657,312</u>	<u>903,656</u>	<u>608,813</u>
REVENUES IN EXCESS OF EXPENSES	<u>699,400</u>	<u>1,131,510</u>	<u>(165,604)</u>
Capital contributions and grants	<u>-</u>	<u>333,347</u>	<u>-</u>
Increase in net assets	<u>699,400</u>	<u>1,464,857</u>	<u>(165,604)</u>
Net assets, beginning of year	<u>13,930,703</u>	<u>12,465,846</u>	<u>12,631,450</u>
Net assets, end of year	<u>\$ 14,630,103</u>	<u>\$ 13,930,703</u>	<u>\$ 12,465,846</u>

Net patient and resident service revenue made up 93.9% in 2006 and 93.5% in 2005 of the Health System's total operating revenues. To arrive at net patient and resident service revenue, contractual adjustments have been made to gross patient and resident service revenue due to agreements with third-party payors. Increases in net revenue relate to increases in acute days as well as increases in ancillary services, such as surgery, anesthesiology, radiology, laboratory, physical therapy, pharmacy, emergency, and clinic.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS – PAGE 5
YEARS ENDED JUNE 30, 2006 AND 2005

Table 3 below shows the contractual adjustments that were recognized:

Table 3: Net Patient and Resident Service Revenue and Contractual Adjustments

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total patient and resident service revenue	\$ 21,639,050	\$ 20,189,029	\$ 17,769,288
Contractual adjustments and provision for bad debts	<u>(7,254,739)</u>	<u>(6,472,612)</u>	<u>(5,751,648)</u>
Net patient and resident service revenue	<u>\$ 14,384,311</u>	<u>\$ 13,716,417</u>	<u>\$ 12,017,640</u>
Contractual adjustments and provision for bad debts as a percent of revenues	<u>33.53%</u>	<u>32.06%</u>	<u>32.37%</u>

Total operating expenses increased by \$822,053 or 5.7% in 2006 and increased by \$754,466 or 5.5% in 2005. Salary and benefit increases and the cost of supplies drove the majority of the increase in expense. The operating expenses are broken down by department on the Schedules of Operating Expenses; please see pages 36-39 of the audited financial statements for this information.

Operating income (total operating revenues less total operating expenses) was a gain of \$79,933 or .5% of total operating revenues in 2006 compared to an operating gain of \$245,735 or 1.7% in 2005.

Other operating revenues decreased by \$6,943 or 1.2% and increased by \$68,813 or 13.3% in 2005. Table 4 shows the detail for this line item.

Table 4: Other Revenues

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Home health support	\$ 391,675	\$ 361,260	\$ 333,227
Lifeline	45,537	42,208	34,912
Meals sold	68,166	66,356	61,367
Rural transition grant	65,643	102,888	71,285
Miscellaneous	<u>6,663</u>	<u>11,915</u>	<u>15,023</u>
Total other revenues	<u>\$ 577,684</u>	<u>\$ 584,627</u>	<u>\$ 515,814</u>

Nonoperating revenues decreased by \$246,344 or 27.3% in 2006 and increased \$294,843 or 48.4% in 2005. The two main reasons for the decrease is market value losses on investments and contributions received being forwarded directly to the Palo Alto County Healthcare Foundation.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS – PAGE 6
YEARS ENDED JUNE 30, 2006 AND 2005

Health System Statistical Data

Table 5 shows the Health System's statistical data. In comparison, there is a direct correlation between utilization changes and revenue changes.

Table 5: Statistical Data

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Patient Days			
Acute	1,890	1,947	1,810
Swing bed	829	637	674
Newborn	190	217	194
Long-term care	7,246	7,214	7,414
Total	<u>10,155</u>	<u>10,015</u>	<u>10,092</u>
Admissions			
Acute	676	679	628
Swing bed	147	134	136
Long-term care	21	18	25
Total	<u>844</u>	<u>831</u>	<u>789</u>
Discharges			
Acute	676	679	627
Swing bed	147	134	135
Long-term care	21	19	23
Total	<u>844</u>	<u>832</u>	<u>785</u>
Average length of stay, acute	<u>2.8</u>	<u>2.9</u>	<u>2.9</u>
Beds			
Acute and swing	25	25	32
Long-term care	22	22	22
Occupancy percentage			
Acute and swing	29.8%	28.3%	21.3%
Long-term care	90.2%	89.8%	92.3%

The Health System's Cash Flows

The Health System's cash flows are consistent with the changes in operating income and financial performance, as discussed earlier.

Capital Assets

At June 30, 2006, the Health System had \$10,604,592 invested in capital assets net of accumulated depreciation. In 2006, the Health System expended \$853,140 to purchase capital assets. In 2005, the Health System purchased capital assets costing \$725,829.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS – PAGE 7
YEARS ENDED JUNE 30, 2006 AND 2005

Long-term Debt

Table 6 shows a summary of the Health System's long-term debt outstanding.

Table 6: Long-term Debt

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Hospital Revenue Bonds, Series 2003	\$ 6,400,000	\$ 6,570,000	\$ 6,735,000
Capital lease obligations	-	-	54,809
	<u>6,400,000</u>	<u>6,570,000</u>	<u>6,789,809</u>
Less:			
Bond discount	(20,616)	(21,548)	(22,480)
Deferred loss on bond refinancing	<u>(131,306)</u>	<u>(137,240)</u>	<u>(143,174)</u>
Total long-term debt	<u>\$ 6,248,078</u>	<u>\$ 6,411,212</u>	<u>\$ 6,624,155</u>

The most significant number in Table 6 is the Hospital Revenue Bonds, Series 2003. The County Board of Supervisors adopted a resolution authorizing the issuance of \$7,000,000 of Hospital Revenue Notes in August 1998 to finance the renovation of the Health System. The Series 1998 bonds were refunded by the 2003 Hospital Revenue Bonds in order to obtain lower interest rates. The 2003 bonds are payable through August 1, 2029, with interest coupons payable at February 1 and August 1 at annual rates varying from 1.70% to 5.40%. The Bonds due after August 1, 2010, may be called for redemption in whole or part at principal plus accrued interest upon 30 days notice. Special term notes maturing on August 1, 2029, are subject to special obligatory redemption at principal plus accrued interest from amounts on deposit in the sinking and debt service reserve funds on interest payment dates on or after August 1, 2005.

Economic Factors

The Health System continued to improve its financial position during the current year. However, the current condition of the economy continues to be a concern for Health System officials. Some of the realities that may potentially become challenges for the Health System are as follows:

- Expenses continue to increase.
- Facilities at the Health System require continued maintenance and upkeep.
- Technology continues to expand and current technology becomes outdated, presenting an ongoing challenge to maintain up-to-date technology at a reasonable cost. There is the need to have the Electronic Health Record in place by 2010.
- Potential changes in federal and state reimbursement for patient services.

The Health System anticipates the current fiscal year will be much like the last and will maintain a close watch over resources to maintain the Health System's ability to react to unknown issues.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS – PAGE 8
YEARS ENDED JUNE 30, 2006 AND 2005

Contacting the Health System

The financial report is designed to provide our citizens, customers, and creditors with a general overview of the Health System's finances and to demonstrate the Health System's accountability for the money it receives. If you have any questions about this report or need additional information, please contact Thomas J. Lee, Administrator at Palo Alto County Health Systems, 3201 First Street, Emmetsburg, IA, 50536.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
BALANCE SHEETS
JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 4,975,690	\$ 3,372,303
Restricted by bond agreement	320,223	632,782
Receivables		
Patient and resident, less allowance for uncollectible amounts of \$1,143,000 in 2006 and \$1,120,000 in 2005	2,020,941	2,175,820
Succeeding year property tax receivable	823,200	470,832
Other	107,585	71,241
Supplies	280,742	263,733
Prepaid expenses	<u>98,952</u>	<u>48,246</u>
Total current assets	<u>8,627,333</u>	<u>7,034,957</u>
OTHER ASSETS	<u>159,311</u>	<u>166,511</u>
ASSETS LIMITED AS TO USE OR RESTRICTED		
Internally designated for capital improvements	4,145,494	5,163,472
Restricted by bond agreement	463,346	463,346
Restricted by contributors and grantors	<u>-</u>	<u>45,237</u>
Total assets limited as to use or restricted	<u>4,608,840</u>	<u>5,672,055</u>
CAPITAL ASSETS		
Land and construction in progress, not being depreciated	421,703	149,631
Other capital assets being depreciated	17,731,314	17,487,707
Less accumulated depreciation	<u>(7,548,425)</u>	<u>(6,932,977)</u>
Net capital assets	<u>10,604,592</u>	<u>10,704,361</u>
Total assets	<u><u>\$ 24,000,076</u></u>	<u><u>\$ 23,577,884</u></u>

	2006	2005
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 175,000	\$ 170,000
Accounts payable	610,893	794,841
Accrued expenses		
Salaries and wages	234,978	265,643
Paid leave	366,387	366,231
Interest	121,019	122,436
Payroll taxes and employee benefits	34,194	31,188
Estimated health claims payable	175,037	111,000
Estimated third-party payor settlements	733,001	1,055,639
Deferred revenue for succeeding year property tax receivable	823,200	470,832
Total current liabilities	3,273,709	3,387,810
OTHER LIABILITIES		
Security deposits	23,186	18,159
LONG-TERM DEBT, net of current maturities	<u>6,073,078</u>	<u>6,241,212</u>
Total liabilities	<u>9,369,973</u>	<u>9,647,181</u>
NET ASSETS		
Invested in capital assets net of related debt	4,515,825	4,459,660
Restricted		
By bond agreement	783,569	1,096,128
By contributors and grantors	-	45,237
Unrestricted	<u>9,330,709</u>	<u>8,329,678</u>
Total net assets	<u>14,630,103</u>	<u>13,930,703</u>
Total liabilities and net assets	<u>\$ 24,000,076</u>	<u>\$ 23,577,884</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
BALANCE SHEETS –
PALO ALTO COUNTY HEALTH CARE FOUNDATION
DECEMBER 31, 2005 AND 2004

	<u>2005</u>	<u>2004</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 19,195	\$ 47,920
Accrued interest	<u>12,671</u>	<u>15,429</u>
Total current assets	31,866	63,349
NONCURRENT CASH AND INVESTMENTS	1,483,051	1,450,750
CAPITAL ASSETS, NET	<u>45,292</u>	<u>47,827</u>
Total assets	<u><u>\$ 1,560,209</u></u>	<u><u>\$ 1,561,926</u></u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Property tax payable	\$ 768	\$ 768
NET ASSETS, unrestricted	<u>1,559,441</u>	<u>1,561,158</u>
Total liabilities and net assets	<u><u>\$ 1,560,209</u></u>	<u><u>\$ 1,561,926</u></u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
OPERATING REVENUES		
Net patient and resident service revenue (net of provision for bad debts of \$494,332 in 2006 and \$424,026 in 2005)	\$ 14,384,311	\$ 13,716,417
Apartment revenue	359,709	364,409
Other revenues	577,684	584,627
Total operating revenues	<u>15,321,704</u>	<u>14,665,453</u>
OPERATING EXPENSES		
Salaries and wages	5,685,721	5,325,582
Employee benefits	1,638,007	1,397,937
Professional fees	2,534,763	2,525,276
Management, legal, and accounting fees	159,144	156,224
Utilities	258,769	233,295
Insurance	186,193	162,057
Supplies and other expenses	3,528,745	3,336,118
Depreciation	945,633	973,509
Interest and amortization	304,796	309,720
Total operating expenses	<u>15,241,771</u>	<u>14,419,718</u>
OPERATING INCOME BEFORE AFFILIATION AGREEMENT	79,933	245,735
AFFILIATION AGREEMENT EXPENSE (NOTE 8)	<u>(37,845)</u>	<u>(17,881)</u>
INCOME FROM OPERATIONS	<u>42,088</u>	<u>227,854</u>
NONOPERATING REVENUES (EXPENSES)		
Investment income	172,446	344,143
County tax revenue	471,512	466,908
Noncapital grants and contributions	17,426	70,286
Other nonoperating gains	1,004	24,449
Loss on sale of property and equipment	<u>(5,076)</u>	<u>(2,130)</u>
Total nonoperating revenues (expenses)	<u>657,312</u>	<u>903,656</u>
REVENUES IN EXCESS OF EXPENSES	699,400	1,131,510
Capital contributions and grants	<u>-</u>	<u>333,347</u>
INCREASE IN NET ASSETS	699,400	1,464,857
NET ASSETS, BEGINNING OF YEAR	<u>13,930,703</u>	<u>12,465,846</u>
NET ASSETS, END OF YEAR	<u><u>\$ 14,630,103</u></u>	<u><u>\$ 13,930,703</u></u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS –
PALO ALTO COUNTY HEALTH CARE FOUNDATION
YEARS ENDED DECEMBER 31, 2005 AND 2004

	<u>2005</u>	<u>2004</u>
OPERATING REVENUES		
Investment income	\$ 60,214	\$ 109,487
Rental income	7,500	7,700
Contributions	<u>48,582</u>	<u>3,860</u>
Total revenues	<u>116,296</u>	<u>121,047</u>
EXPENSES		
Depreciation	2,535	1,535
Property taxes	768	768
Other expenses	446	47
Contributions to health system	<u>114,264</u>	<u>-</u>
Total expenses	<u>118,013</u>	<u>2,350</u>
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	(1,717)	118,697
NET ASSETS, BEGINNING OF YEAR	<u>1,561,158</u>	<u>1,442,461</u>
NET ASSETS, END OF YEAR	<u>\$ 1,559,441</u>	<u>\$ 1,561,158</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
OPERATING ACTIVITIES		
Receipts of patient and resident service revenue	\$ 14,576,261	\$ 14,508,284
Payments of salaries and wages	(7,287,194)	(6,596,176)
Payments of supplies and other expenses	(8,063,573)	(6,125,337)
Other receipts and payments, net	1,264,276	544,475
NET CASH PROVIDED BY OPERATING ACTIVITIES	489,770	2,331,246
NONCAPITAL FINANCING ACTIVITIES		
Noncapital grants and contribution received	17,426	403,633
County tax revenue received	471,512	466,908
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	488,938	870,541
CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal payments on long-term debt	(170,000)	(221,264)
Acquisition of capital assets	(669,285)	(725,776)
Interest payments on long-term debt	(290,730)	(296,823)
Cash received from insurance proceeds	1,004	24,449
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(1,129,011)	(1,219,414)
INVESTING ACTIVITIES		
Purchase of investments	(657,284)	(956,645)
Sale and transfer of investments	2,221,543	463,015
Investment income received	189,431	42,883
NET CASH PROVIDED BY (USED BY) INVESTING ACTIVITIES	1,753,690	(450,747)
INCREASE IN CASH AND CASH EQUIVALENTS	1,603,387	1,531,626
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	3,372,303	1,840,677
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 4,975,690	\$ 3,372,303

STATEMENTS OF CASH FLOWS – PAGE 2

	2006	2005
RECONCILIATION OF INCOME FROM OPERATIONS TO CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 42,088	\$ 227,854
Adjustments to reconcile income from operations to net cash provided by operating activities		
Depreciation and amortization	945,633	973,509
Interest and amortization considered capital and related financing activity	304,796	310,889
Changes in assets and liabilities		
Patient and resident receivables	154,879	(136,381)
Other receivables	(388,712)	(22,271)
Supplies	(17,009)	5,208
Prepaid expenses	(50,706)	33,322
Accounts payable	(183,948)	249,103
Accrued expenses	(28,920)	126,174
Estimated health claims payable	64,037	-
Estimated third-party payor settlements	(352,368)	563,839
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 489,770</u>	<u>\$ 2,331,246</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS –
PALO ALTO COUNTY HEALTH CARE FOUNDATION
YEARS ENDED DECEMBER 31, 2005 AND 2004

	2005	2004
OPERATING ACTIVITIES		
Change in unrestricted net assets	\$ (1,717)	\$ 118,697
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation	2,535	1,535
Amortization of premiums on investments	10,019	5,278
Changes in assets and liabilities		
Accrued interest receivable	2,758	(5,804)
Due to employees	-	(3,700)
Property tax payable	-	768
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>13,595</u>	<u>116,774</u>
FINANCING ACTIVITIES		
Payments for capital expenditures	-	(16,480)
NET CASH USED FOR FINANCING ACTIVITIES	<u>-</u>	<u>(16,480)</u>
INVESTING ACTIVITIES		
Purchase of investments	(225,232)	(256,090)
Sale of investments	195,000	175,000
Interest capitalized to CDs	(12,088)	(4,821)
NET CASH USED FOR INVESTING ACTIVITIES	<u>(42,320)</u>	<u>(85,911)</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(28,725)	14,383
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>47,920</u>	<u>33,537</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u><u>\$ 19,195</u></u>	<u><u>\$ 47,920</u></u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2006 AND 2005

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Palo Alto County Hospital (the Hospital) consists of a 25-bed acute care hospital and a 22-bed skilled nursing/long-term care facility, located in Emmetsburg, Iowa. It is organized under Chapter 347 of the Code of Iowa. The Health System provides health care services under the name of Palo Alto County Health System (the Health System) in accordance with a Master Affiliation Agreement discussed further in Note 8. Services are provided to residents of Palo Alto County and surrounding counties in Iowa. The Health System is exempt from income taxes as a political subdivision.

Reporting Entity

For financial reporting purposes, the Health System has included all funds, organizations, account groups, agencies, boards, commissions, and authorities. The Health System has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Health System are such that exclusion would cause the Health System's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Health System to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Health System.

Palo Alto County Health Care Foundation (the Foundation) is a legally separate, tax-exempt component unit of the Health System and has a year end of December 31. The Foundation's financial statements have been included as a discretely presented component unit. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the Health System in support of its operations and programs. The Health System does not appoint a voting majority of the Foundation's Board of Directors or in any way impose its will over the Foundation. However, the Foundation is included as a discretely presented component unit due to the nature and significance of its relationship to the Health System.

Basis of Presentation

The balance sheet displays the Health System's assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt attributable to the acquisition, construction or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets not meeting the definition of the two preceding categories. Unrestricted net assets often have constraints on resources imposed by management which can be removed or modified.

NOTES TO FINANCIAL STATEMENTS

When both restricted and unrestricted resources are available for use, it is generally the Health System's policy to use restricted resources first.

Basis of Accounting

The Health System reports in accordance with accounting principles generally accepted in the United States of America as specified by the American Institute of Certified Public Accountants' *Audit and Accounting Guide for Health Care Organizations* and, as a governmental entity, also provides certain disclosures required by the Governmental Accounting Standards Board (GASB). The accompanying financial statements have been prepared on the accrual basis of accounting. Revenues are recognized when earned and expenses are recorded when the liability is incurred.

In reporting its financial activity, the Health System applies all applicable GASB pronouncements for proprietary funds, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less when purchased, excluding assets limited as to use.

Patient and Resident Receivables

Patient and resident receivables are uncollateralized customer and third-party payor obligations. Unpaid patient and resident receivables are not charged interest on amounts owed.

Payments of patient and resident receivables are allocated to the specific claims identified on the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient and resident receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients, residents, and third-party payors. Management reviews patient and resident receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients and residents due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision. Management also reviews accounts to determine if classification as charity care is appropriate.

NOTES TO FINANCIAL STATEMENTS

Property Tax Receivable

Property tax receivable is recognized on the levy or lien date, which is the date that the tax asking is certified by the County Board of Supervisors. The succeeding year property tax receivable represents taxes certified by the Board of Supervisors to be collected in the next fiscal year for the purposes set out in the budget for the next fiscal year. However, by statute, the tax asking and budget certification for the following fiscal year becomes effective on the first day of that year. Although the succeeding year property tax receivable has been recorded, the related revenue is deferred and will not be recognized as revenue until the year for which it is levied.

Deferred Revenue

Although certain revenues are measurable, they are not available. Available means collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. Deferred revenue represents the amount of assets that have been recognized, but the related revenue has not been recognized since the assets are not collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. Deferred revenue consists of succeeding year property tax receivable.

Supplies

Supplies are stated at lower of average cost or market.

Capital Assets

Land, buildings, and equipment acquisitions in excess of \$5,000 are capitalized and recorded at cost. Land, buildings, and equipment donated for the Health System operations are recorded as additions to net assets at fair value at the date of receipt. Depreciation is provided over the estimated useful life of each depreciable asset and is computed using the straight-line method. The estimated useful lives of land, buildings, and equipment are as follows:

Land improvements	8-20 years
Buildings and fixed equipment	5-56 years
Major movable equipment	3-25 years

Donated Assets

Donated supplies; investments; and land, buildings, and equipment are recorded at fair value at date of donation, which then is treated as cost.

Compensated Absences

Hospital employees accumulate a limited amount of earned but unused paid leave hours for subsequent use or for payment upon termination, death, or retirement. The cost of paid leave is recorded as a current liability on the balance sheet. The compensated absences liability has been computed based on rates of pay in effect at June 30.

NOTES TO FINANCIAL STATEMENTS

Assets Limited As to Use or Restricted

Assets limited as to use include assets which are board designated funds. Restricted funds are used to differentiate funds which are limited by the donor to specific uses from funds on which the donor places no restriction or which arise as a result of the operation of the Health System for its stated purposes. Resources set aside for board designated purposes are not considered to be restricted. Contributions are reported in nonoperating revenue. Grants restricted for specific operating purposes are reported as other operating income.

Restricted Net Assets

Restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors, from unrestricted net assets on which donors or grantors place no restriction or which arise as a result of the operations of the Health System for its stated purpose.

Operating Revenues and Expenses

The Health System's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from transactions associated with providing health care services – the Health System's principal activity. Other revenues, including interest income, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, including financing costs.

Net Patient and Resident Service Revenue

Net patient and resident service revenue is reported at the estimated net realizable amounts from patients, residents, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Grants and Contributions

Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

Restricted Resources

When the Health System has both restricted and unrestricted resources available to finance a particular program, it is the Health System's policy to use restricted resources before unrestricted resources.

NOTES TO FINANCIAL STATEMENTS

Charity Care

To fulfill its mission of community service, the Health System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and per diem payments. Patient and resident service revenue is reported at the estimated net realizable amounts from patients, residents, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors and a provision for uncollectible accounts. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Advertising Costs

The Health System expenses advertising costs as incurred.

County Tax Revenue

Taxes are included in nonoperating revenues when received and distributed by the County Treasurer. No provision is made in the financial statements for taxes levied in the current year to be collected in a subsequent year.

Reclassifications

Certain prior period amounts within the accompanying financial statements have been reclassified for comparability. The reclassifications have no effect on the previously reported net income or equity.

NOTE 2 - CHARITY CARE

The Health System maintains records to identify and monitor the level of charity care it provides. The amounts of charges foregone for services and supplies furnished under its charity care policy during the years ending June 30, 2006 and 2005, was \$147,743 and \$42,001, respectively.

NOTES TO FINANCIAL STATEMENTS

NOTE 3 - NET PATIENT AND RESIDENT SERVICE REVENUE

The Health System has agreements with third-party payors that provide for payments to the Health System at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare

The Health System is licensed as a Critical Access Hospital (CAH). The Health System is reimbursed for most inpatient and outpatient services at cost with final settlement determined after submission of annual cost reports by the Health System and are subject to audits thereof by the Medicare fiscal intermediary. The Health System's Medicare cost reports have been settled by the Medicare fiscal intermediary through the year ended June 30, 2004. The Health System's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Health System.

Medicaid

Hospital

Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid based on a cost reimbursement methodology. The Health System is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Health System and audits thereof by the Medicaid fiscal intermediary. The Health System's Medicaid cost reports have been processed by the Medicaid fiscal intermediary through June 30, 2001.

Nursing Home

Routine services rendered to nursing home residents who are beneficiaries of the Medicaid program are paid according to a schedule of prospectively determined daily rates.

Other Payors

The Health System has also entered into payment agreements with Blue Cross and other commercial insurance carriers. The basis for reimbursement under these agreements includes discounts from established charges and prospectively determined rates.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Revenue from the Medicare and Medicaid programs accounted for approximately 55% and 8%, respectively, of the Health System's net patient and resident service revenue for the year ended 2006, and 54% and 7%, respectively, of the Health System's net patient and resident service revenue for the year ended 2005.

NOTES TO FINANCIAL STATEMENTS

A summary of patient and resident service revenue, contractual adjustments, and provision for bad debts is as follows:

	<u>2006</u>	<u>2005</u>
Total patient and resident service revenue	<u>\$ 21,639,050</u>	<u>\$ 20,189,029</u>
Contractual adjustments		
Medicare	4,557,858	4,137,460
Medicaid	544,641	439,658
Other	<u>1,657,908</u>	<u>1,471,468</u>
Total contractual adjustments	<u>6,760,407</u>	<u>6,048,586</u>
Net patient and resident service revenue	14,878,643	14,140,443
Provision for bad debts	<u>(494,332)</u>	<u>(424,026)</u>
Net patient and resident service revenue (net of provision for bad debts)	<u>\$ 14,384,311</u>	<u>\$ 13,716,417</u>

Concentration of Credit Risk

The Hospital grants credit without collateral to its patients and residents, most of whom are insured under third-party payor agreements. The mix of receivables from third-party payors, patients, and residents at June 30, 2006 and 2005, was as follows:

	<u>2006</u>	<u>2005</u>
Medicare	35.8%	39.9%
Medicaid	7.5%	14.2%
Blue Cross	14.6%	10.0%
Other third-party payors, patients, and residents	<u>42.1%</u>	<u>35.9%</u>
	<u>100.0%</u>	<u>100.0%</u>

NOTE 4 - DEPOSITS AND INVESTMENTS

The Health System's deposits in banks at June 30, 2006 and 2005, were entirely covered by Federal Depository Insurance, or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Health System is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees and the Treasurer of the State of Iowa; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts, and warrants or improvement certificates of a drainage district.

NOTES TO FINANCIAL STATEMENTS

Interest rate risk is the exposure to fair value losses resulting from rising interest rates. The Health System's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in investments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Health System. Maturities are consistent with this policy.

NOTE 5 - CAPITAL ASSETS

Summaries of capital assets at June 30, 2006 and 2005, are as follows:

	Balance June 30, 2005	Additions	Deductions	Balance June 30, 2006
Cost				
Land and land improvements	\$ 351,581	\$ -	\$ -	\$ 351,581
Building	10,661,790	15,262	-	10,677,052
Fixed equipment	1,982,256	36,950	(3,089)	2,016,117
Major movable equipment	4,632,445	528,857	(334,374)	4,826,928
Construction in process	9,266	272,071	-	281,337
	<u>17,637,338</u>	<u>853,140</u>	<u>(337,463)</u>	<u>18,153,015</u>
Accumulated depreciation				
Land improvements	111,117	16,772	-	127,889
Buildings	2,541,650	351,251	-	2,892,901
Fixed equipment	1,233,384	82,428	(2,370)	1,313,442
Major movable equipment	3,046,826	495,182	(327,817)	3,214,191
	<u>6,932,977</u>	<u>945,633</u>	<u>(330,187)</u>	<u>7,548,423</u>
Capital assets, net	<u>\$ 10,704,361</u>			<u>\$ 10,604,592</u>

NOTES TO FINANCIAL STATEMENTS

	Balance June 30, 2004	Additions	Deductions	Balance June 30, 2005
Cost				
Land and land improvements	\$ 339,200	\$ 12,381	\$ -	\$ 351,581
Building	10,595,290	66,500	-	10,661,790
Fixed equipment	1,983,559	-	(1,303)	1,982,256
Major movable equipment	4,139,711	637,682	(144,948)	4,632,445
Construction in process	-	9,266	-	9,266
	<u>17,057,760</u>	<u>725,829</u>	<u>(146,251)</u>	<u>17,637,338</u>
Accumulated depreciation				
Land improvements	90,173	20,944	-	111,117
Buildings	2,188,220	353,430	-	2,541,650
Fixed equipment	1,145,972	88,715	(1,303)	1,233,384
Major movable equipment	<u>2,679,172</u>	<u>510,420</u>	<u>(142,766)</u>	<u>3,046,826</u>
	<u>6,103,537</u>	<u>973,509</u>	<u>(144,069)</u>	<u>6,932,977</u>
Capital assets, net	<u>\$ 10,954,223</u>			<u>\$ 10,704,361</u>

Construction in progress at June 30, 2006, consists of costs incurred for architect fees for the potential renovation in fiscal year 2007.

NOTES TO FINANCIAL STATEMENTS

NOTE 6 - LONG-TERM DEBT

A schedule of changes in long-term debt for 2006 and 2005, is as follows:

	Balance June 30, 2005	Additions	Payments (Amortization)	Balance June 30, 2006	Amounts Due Within One Year
Hospital Revenue Bonds, Series 2003	\$ 6,570,000	\$ -	\$ (170,000)	\$ 6,400,000	\$ 175,000
Bond discount	(21,548)	-	932	(20,616)	-
Deferred loss on bond refinancing	(137,240)	-	5,934	(131,306)	-
Total long-term debt	<u>\$ 6,411,212</u>	<u>\$ -</u>	<u>\$ (163,134)</u>	<u>\$ 6,248,078</u>	<u>\$ 175,000</u>

	Balance June 30, 2004	Additions	Payments (Amortization)	Balance June 30, 2005	Amounts Due Within One Year
Hospital Revenue Bonds, Series 2003	\$ 6,735,000	\$ -	\$ (165,000)	\$ 6,570,000	\$ 170,000
Obligations under capital lease	54,809	-	(54,809)	-	-
	6,789,809	-	(219,809)	6,570,000	170,000
Bond discount	(22,480)	-	932	(21,548)	-
Deferred loss on bond refinancing	(143,174)	-	5,934	(137,240)	-
Total long-term debt	<u>\$ 6,624,155</u>	<u>\$ -</u>	<u>\$ (212,943)</u>	<u>\$ 6,411,212</u>	<u>\$ 170,000</u>

The Hospital Revenue Bonds, Series 2003 were issued in the amount of \$6,735,000 on August 1, 2003. Payments of interest at rates from 1.7% to 5.4% are payable semi-annually on February 1 and August 1, and principal payments are due annually on August 1 through 2029. The bonds are collateralized by the patient and resident revenues of the Health System.

The Health System is subject to certain covenants under the bond agreement regarding the funding of debt service reserve and sinking fund accounts. The Health System was in compliance with these covenants for the years ended June 30, 2006 and 2005.

NOTES TO FINANCIAL STATEMENTS

Aggregate future payments of principal and interest on the long-term debt obligations are as follows:

Year Ending June 30,	Long-term Debt	
	Principal	Interest
2007	\$ 175,000	\$ 288,346
2008	175,000	283,796
2009	180,000	278,556
2010	190,000	272,536
2011	195,000	265,650
2012 to 2016	1,095,000	1,198,466
2017 to 2021	1,370,000	909,405
2022 to 2026	1,765,000	507,063
2027 to 2029	1,255,000	88,222
	<u>\$ 6,400,000</u>	<u>\$ 4,092,040</u>

NOTE 7 - PENSION AND RETIREMENT BENEFITS

The Health System contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits, which are established by state statute, to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 3.70% of their annual salary and the Health System is required to contribute 5.75% of annual covered payroll for the years ended June 30, 2006, 2005, and 2004. Contribution requirements are established by State statute. The Health System's contribution to IPERS for the years ended June 30, 2006, 2005, and 2004, were approximately \$331,761, \$301,048, and \$292,495, respectively, equal to the required contributions for each year.

NOTE 8 - RELATED ORGANIZATIONS

Master Affiliation Agreement

The Health System has a Master Affiliation Agreement with Mercy Medical Center – North Iowa (MMC-NI) to provide hospital, physician, and other health care services in Wright and surrounding counties in central Iowa. As a part of this Master Affiliation Agreement, the Health System entered into a Professional Service Agreement with MMC-NI whereby MMC-NI provides professional medical services for the Health System. Amounts paid to MMC-NI for the provision of these services amounted to \$1,700,223 and \$1,297,783 for the years ended June 30, 2006 and 2005, respectively.

Operating gains and losses from the consolidated operation of Health System and MMC-NI services are shared equally in accordance with the formulas outlined in the Master Affiliation Agreement. Total operating gains to be allocated to MMC-NI amounted to \$37,845 and \$17,881, respectively, for the years ending June 30, 2006 and 2005, for the various services and distributions related to these agreements.

NOTES TO FINANCIAL STATEMENTS

Management Services

The Health System has a contractual arrangement with MMC-NI under which MMC-NI provides administrative staff, management consultation, and other services to the Health System. The arrangement does not alter the authority or responsibility of the Board of Trustees of the Health system. Expenses of the administrative and management services for the years ending June 30, 2006 and 2005, were \$111,467 and \$105,530, respectively.

Due to and from Affiliated Organization

As of June 30, 2006 and 2005, the Health System's records reflect an amount due to MMC-NI of \$165,168 and \$267,783, respectively, for the various services and distributions related to these agreements.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Health System Risk Management

The Health System is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. These risks are covered by commercial insurance purchased from independent third parties. There has been no significant reduction in insurance coverage from the previous year in any of the Health System's policies. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

The Health System's employees participate in a self-funded health plan (Plan). The amounts payable from the Plan at June 30, 2006 and 2005 total \$175,037 and \$111,000, respectively, which is for incurred but not reported (IBNR) and reported but not paid claims. The amounts are based on estimates of the amounts necessary to pay current year claims. The Plan has purchased stop loss coverage.

Malpractice Insurance

The Health System has insurance coverage to provide protection for professional liability losses on a claims made basis subject to a limit of \$1 million per claim and an aggregate limit of \$3 million. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, will be uninsured.

Litigation

The Health System is involved in litigation resulting from the normal course of business. The litigation is in the discovery state and may ultimately be brought to trial. It is the intent of the legal council and management, to vigorously defend the Health System in regards to this case. Due to being in the early stages of litigation an evaluation of the likelihood of an unfavorable outcome and estimate of potential loss, if any, to the Health System is not possible.

NOTES TO FINANCIAL STATEMENTS

Health Care Legislation and Regulation

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient and resident services and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violation of these laws and regulations could result in expulsion from government health care programs together with imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that the Health System is in substantial compliance with fraud and abuse as well as other applicable government laws and regulations. While no regulatory inquiries have been made, compliance with such laws and regulation is subject to government review and interpretation, as well as regulator actions unknown or unasserted at this time.

Commitment

Palo Alto County Hospital d/b/a Palo Alto County Health System entered into an agreement with Mercy Medical Center – North Iowa regarding electronic hospital records for which the Hospital's share will be approximately \$1,500,000.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
BUDGETARY COMPARISON SCHEDULE OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS AND NOTES - BUDGET AND ACTUAL (CASH BASIS)
YEAR ENDED JUNE 30, 2006

	Actual Accrual Basis	Accrual Adjustments	Actual Cash Basis	Budget	Variance Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 471,512	\$ -	\$ 471,512	\$ 457,860	\$ 13,652
Estimated other revenues/receipts	<u>15,507,504</u>	<u>333,033</u>	<u>15,840,537</u>	<u>15,430,416</u>	<u>410,121</u>
	15,979,016	333,033	16,312,049	15,888,276	423,773
Expenses/disbursements	<u>15,279,616</u>	<u>71,151</u>	<u>15,350,767</u>	<u>15,362,000</u>	<u>11,233</u>
Net	699,400	261,882	961,282	526,276	435,006
Balance beginning of year	<u>13,930,703</u>	<u>(10,558,400)</u>	<u>3,372,303</u>	<u>9,680,597</u>	<u>(6,308,294)</u>
Balance end of year	<u><u>\$14,630,103</u></u>	<u><u>\$(10,296,518)</u></u>	<u><u>\$ 4,333,585</u></u>	<u><u>\$10,206,873</u></u>	<u><u>\$ (5,873,288)</u></u>

NOTE 1

This budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary prospective differences.

The Board of Trustees annually prepares and adopts a budget designating the amount necessary for the improvement and maintenance of the Health System on the cash basis following required public notice and hearing in accordance with Chapters 24 and 347 of the Code of Iowa. The Board of Trustees certifies the approved budget to the appropriate county auditors. The budget may be amended during the year utilizing similar statutorily prescribed procedures. Formal and legal budgetary control is based on total expenditures. The budget was amended during the year ended June 30, 2006.



INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

The Board of Trustees
Palo Alto County Hospital
d/b/a Palo Alto County Health System
Emmetsburg, Iowa

Our audit was performed for the purpose of forming an opinion on the 2006 basic financial statements taken as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information except for the schedule of comparative statistics on page 42 marked "unaudited" has been subjected to the auditing procedures applied in the audit of the 2006 financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The 2005 supplementary information has been subjected to auditing procedures by other auditors applied in their audit of the 2005 basic financial statements and, in their opinion was fairly stated in relation to the 2005 basic financial statements taken as a whole.

Minneapolis, Minnesota
July 20, 2006

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PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF NET PATIENT AND RESIDENT SERVICE REVENUE
YEARS ENDED JUNE 30, 2006 AND 2005

	TOTAL	
	2006	2005
PATIENT AND RESIDENT SERVICE REVENUE		
Medical and surgical	\$ 1,456,054	\$ 1,218,069
Intensive care unit	9,498	3,836
Nursery	71,424	77,680
Long-term care	737,589	772,689
Total	2,274,565	2,072,274
OTHER PROFESSIONAL SERVICES		
Operating room	1,859,893	1,473,240
Labor and delivery room	48,699	60,350
Anesthesiology	514,200	476,960
Radiology	3,041,475	2,865,668
Laboratory	2,722,058	2,552,538
Respiratory therapy	918,098	751,265
Physical therapy	742,313	781,672
Audiology	23,133	13,977
Occupational therapy	178,574	90,425
Speech therapy	5,111	3,859
Electrocardiography	459,556	535,037
Medical and surgical supplies	420,786	485,050
Pharmacy	1,498,154	1,373,413
Graettinger Clinic	463,498	459,211
Emmetsburg Clinic	3,305,641	2,975,177
West Bend Clinic	677,151	673,713
Emergency room	1,577,537	1,531,565
Ambulance	415,536	417,552
Home health	450,694	412,532
Hospice	190,121	225,552
Total	19,512,228	18,158,756
Total	21,786,793	20,231,030
Charity care	(147,743)	(42,001)
Total patient and resident service revenue	21,639,050	20,189,029
Adjustments to patient and resident service revenue	(7,254,739)	(6,472,612)
NET PATIENT AND RESIDENT SERVICE REVENUE	\$ 14,384,311	\$ 13,716,417

INPATIENT		OUTPATIENT	
2006	2005	2006	2005
\$ 1,456,054	\$ 1,218,069	\$ -	\$ -
9,498	3,836	-	-
71,424	77,680	-	-
737,589	772,689	-	-
2,274,565	2,072,274	-	-
346,613	307,867	1,513,280	1,165,373
48,699	60,350	-	-
83,673	82,143	430,527	394,817
340,496	330,858	2,700,979	2,534,810
581,034	483,734	2,141,024	2,068,804
726,102	559,243	191,996	192,022
172,787	140,809	569,526	640,863
-	-	23,133	13,977
55,219	17,571	123,355	72,854
2,974	2,084	2,137	1,775
37,079	46,646	422,477	488,391
119,070	128,483	301,716	356,567
688,998	606,741	809,156	766,672
-	-	463,498	459,211
-	-	3,305,641	2,975,177
-	-	677,151	673,713
96,683	105,328	1,480,854	1,426,237
-	-	415,536	417,552
-	-	450,694	412,532
27,077	22,079	163,044	203,473
3,326,504	2,893,936	16,185,724	15,264,820
\$ 5,601,069	\$ 4,966,210	\$ 16,185,724	\$ 15,264,820

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF ADJUSTMENTS TO PATIENT AND RESIDENT SERVICE REVENUE
AND OTHER REVENUES
YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
ADJUSTMENTS TO PATIENT AND RESIDENT SERVICE REVENUE		
Contractual adjustments - Medicare	\$ 4,557,858	\$ 4,137,460
Contractual adjustments - Medicaid	544,641	439,658
Provision for bad debts	494,332	424,026
Other allowances and adjustments	<u>1,657,908</u>	<u>1,471,468</u>
TOTAL ADJUSTMENTS	<u>\$ 7,254,739</u>	<u>\$ 6,472,612</u>
OTHER REVENUES		
Meals sold	\$ 68,166	\$ 66,356
Lifeline	45,537	42,208
Rural transition grant	65,643	102,888
Home health support	391,675	361,260
Miscellaneous	<u>6,663</u>	<u>11,915</u>
TOTAL OTHER REVENUES	<u>\$ 577,684</u>	<u>\$ 584,627</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
MEDICAL AND SURGICAL		
Salaries and wages	\$ 711,480	\$ 633,232
Supplies and other	92,808	91,481
	<u>804,288</u>	<u>724,713</u>
INTENSIVE CARE UNIT		
Salaries and wages	3,975	(473)
Supplies and other	1,273	2,735
	<u>5,248</u>	<u>2,262</u>
NURSERY		
Salaries and wages	32,239	35,242
Supplies and other	4,936	5,493
	<u>37,175</u>	<u>40,735</u>
LONG-TERM CARE		
Salaries and wages	472,878	438,589
Supplies and other	53,690	69,322
	<u>526,568</u>	<u>507,911</u>
NURSING ADMINISTRATION		
Salaries and wages	128,253	94,717
Supplies and other	12,954	6,826
	<u>141,207</u>	<u>101,543</u>
OPERATING AND RECOVERY ROOMS		
Salaries and wages	262,800	245,371
Supplies and other	154,653	200,073
	<u>417,453</u>	<u>445,444</u>
DELIVERY AND LABOR ROOMS		
Salaries and wages	14,783	18,047
Supplies and other	4,337	4,717
	<u>19,120</u>	<u>22,764</u>
ANESTHESIOLOGY		
Supplies and other	242,750	240,176
	<u>242,750</u>	<u>240,176</u>
RADIOLOGY		
Salaries and wages	264,656	281,799
Supplies and other	387,821	349,953
	<u>652,477</u>	<u>631,752</u>

SCHEDULES OF OPERATING EXPENSES – PAGE 2

	2006	2005
LABORATORY		
Salaries and wages	\$ 283,801	\$ 267,769
Supplies and other	440,719	453,472
	<u>724,520</u>	<u>721,241</u>
RESPIRATORY THERAPY		
Salaries and wages	16,906	13,174
Supplies and other	49,306	42,511
	<u>66,212</u>	<u>55,685</u>
PHYSICAL THERAPY		
Salaries and wages	228,528	205,518
Supplies and other	35,256	34,581
	<u>263,784</u>	<u>240,099</u>
AUDIOLOGY		
Supplies and other	6,508	5,226
OCCUPATIONAL THERAPY		
Salaries and wages	97,460	97,808
Supplies and other	46,071	20,805
	<u>143,531</u>	<u>118,613</u>
SPEECH PATHOLOGY		
Supplies and other	5,974	4,788
ELECTROCARDIOGRAPHY		
Salaries and wages	86,488	85,325
Supplies and other	73,956	94,526
	<u>160,444</u>	<u>179,851</u>
MEDICAL SUPPLIES		
Salaries and wages	19,675	12,178
Supplies and other	181,877	167,183
	<u>201,552</u>	<u>179,361</u>
PHARMACY		
Supplies and other	390,378	381,416
GRAETTINGER CLINIC		
Salaries and wages	172,420	153,040
Supplies and other	145,342	178,557
	<u>317,762</u>	<u>331,597</u>

SCHEDULES OF OPERATING EXPENSES – PAGE 3

	2006	2005
EMMETSBURG CLINIC		
Salaries and wages	\$ 566,854	\$ 512,961
Supplies and other	1,728,721	1,655,523
	<u>2,295,575</u>	<u>2,168,484</u>
WEST BEND CLINIC		
Salaries and wages	204,170	187,842
Supplies and other	273,649	283,082
	<u>477,819</u>	<u>470,924</u>
EMERGENCY SERVICES		
Salaries and wages	318,742	286,077
Supplies and other	426,745	383,393
	<u>745,487</u>	<u>669,470</u>
AMBULANCE		
Salaries and wages	175,990	166,994
Supplies and other	67,145	146,667
	<u>243,135</u>	<u>313,661</u>
HOME HEALTH		
Salaries and wages	420,328	439,625
Supplies and other	174,347	158,063
	<u>594,675</u>	<u>597,688</u>
HOSPICE		
Salaries and wages	44,462	45,414
Supplies and other	36,292	45,635
	<u>80,754</u>	<u>91,049</u>
MEDICAL RECORDS		
Salaries and wages	162,436	140,417
Supplies and other	38,156	35,281
	<u>200,592</u>	<u>175,698</u>
DIETARY		
Salaries and wages	228,838	219,492
Supplies and other	149,348	130,819
	<u>378,186</u>	<u>350,311</u>

SCHEDULES OF OPERATING EXPENSES – PAGE 4

	2006	2005
OPERATION OF PLANT		
Salaries and wages	\$ 181,695	\$ 129,050
Supplies and other	345,886	256,813
	<u>527,581</u>	<u>385,863</u>
HOUSEKEEPING		
Salaries and wages	119,944	106,485
Supplies and other	18,748	18,976
	<u>138,692</u>	<u>125,461</u>
LAUNDRY		
Salaries and wages	15,145	13,093
Supplies and other	890	805
	<u>16,035</u>	<u>13,898</u>
BLOOD		
Salaries and wages	3,447	6,869
Supplies and other	79,641	98,535
	<u>83,088</u>	<u>105,404</u>
ADMINISTRATIVE SERVICES		
Salaries and wages	414,123	458,716
Supplies and other	876,632	778,469
	<u>1,290,755</u>	<u>1,237,185</u>
DIABETIC EDUCATION		
Salaries and wages	7,484	7,215
	<u>7,484</u>	<u>7,215</u>
APARTMENTS		
Salaries and wages	25,721	23,996
Supplies and other	120,783	67,042
	<u>146,504</u>	<u>91,038</u>
VAN EXPENSE		
Supplies and other	22	26
	<u>22</u>	<u>26</u>
UNASSIGNED EXPENSES		
Depreciation	945,633	973,509
Interest and amortization	304,796	309,720
Employee benefits	1,638,007	1,397,937
	<u>2,888,436</u>	<u>2,681,166</u>
TOTAL OPERATING EXPENSES	<u>\$ 15,241,771</u>	<u>\$ 14,419,718</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
PATIENTS' AND RESIDENTS' RECEIVABLES
AND ALLOWANCE FOR DOUBTFUL ACCOUNTS
JUNE 30, 2006 AND 2005

ANALYSIS OF AGING

Age of Accounts (Days Since Discharge)	2006		2005	
	Amount	Percent to Total	Amount	Percent to Total
30 days or less	\$ 1,660,719	52.48%	\$ 1,867,191	56.65%
31 to 60 days	713,743	22.56%	588,524	17.86%
61 to 90 days	190,174	6.01%	181,793	5.52%
91 days and over	599,560	18.95%	658,279	19.97%
	<u>3,164,196</u>	<u>100.00%</u>	<u>3,295,787</u>	<u>100.00%</u>
Less: Allowance for doubtful accounts	421,367		355,010	
Allowance for contractual adjustments	<u>721,888</u>		<u>764,957</u>	
Net	<u>\$ 2,020,941</u>		<u>\$ 2,175,820</u>	
Net patient and resident service revenue per calendar day-excluding bad debt	<u>\$ 39,409</u>		<u>\$ 37,579</u>	
Days of net revenue in net accounts receivable at year end	<u>51</u>		<u>58</u>	

ANALYSIS OF ALLOWANCE FOR DOUBTFUL ACCOUNTS

	2006		2005	
	Amount	Percent of Net Patient and Resident Service Revenue	Amount	Percent of Net Patient and Resident Service Revenue
Beginning balance	<u>\$ 355,010</u>		<u>\$ 275,656</u>	
Add:				
Provision for bad debts	494,332	3.44%	424,026	3.10%
Recoveries previously written off	<u>264,961</u>	<u>1.84%</u>	<u>261,051</u>	<u>1.90%</u>
	759,293		685,077	
Less:				
Accounts written off	<u>(692,936)</u>	<u>4.82%</u>	<u>(605,723)</u>	<u>4.40%</u>
Ending balance	<u>\$ 421,367</u>		<u>\$ 355,010</u>	

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF SUPPLIES AND PREPAID EXPENSES
JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
SUPPLIES		
General	\$ 38,476	\$ 44,112
Pharmacy	108,385	92,172
Dietary	8,329	7,867
Other	<u>125,552</u>	<u>119,582</u>
Total supplies	<u>\$ 280,742</u>	<u>\$ 263,733</u>
 PREPAID EXPENSES		
Prepaid insurance	\$ 52,846	\$ 6,612
Prepaid other	<u>46,106</u>	<u>41,634</u>
Total prepaid expenses	<u>\$ 98,952</u>	<u>\$ 48,246</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF COMPARATIVE STATISTICS
YEARS ENDED JUNE 30, 2006 AND 2005 (UNAUDITED)

	2006	2005
PATIENT DAYS		
Acute	1,890	1,947
Long-term care	7,246	7,214
Swing-bed	829	637
Nursery	190	217
Totals	10,155	10,015
ADMISSIONS		
Acute	677	679
Swing-bed	146	134
Long-term care	21	18
Totals	844	831
DISCHARGES		
Acute	676	679
Swing-bed	147	134
Long-term care	21	19
Totals	844	832
ACUTE AVERAGE LENGTH OF STAY	2.8	2.9
SWING BED AVERAGE LENGTH OF STAY	5.6	4.8
ACUTE BEDS	25	25
LONG-TERM CARE BEDS	22	22
PERCENTAGE OF OCCUPANCY		
Acute (based on 25 beds)	29.8%	28.3%
Long-term care (based on 22 beds)	90.2%	89.8%



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

The Board of Trustees
Palo Alto County Hospital
d/b/a Palo Alto County Health System
Emmetsburg, Iowa

We have audited the accompanying balance sheet of **Palo Alto County Hospital, d/b/a Palo Alto County Health System (Health System)**, as of June 30, 2006, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the year then ended and have issued our report thereon dated July 20, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the internal control over financial reporting of **Palo Alto County Hospital, d/b/a Palo Alto County Health System**, in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of **Palo Alto County Hospital, d/b/a Palo Alto County Health System**, are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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Comments involving statutory and other legal matters about the Health Center's operations for the year ended June 30, 2006, are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Health Center. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

This report, a public record by law, is intended solely for the information and use of the officials, employees, and constituents of **Palo Alto County Hospital, d/b/a Palo Alto County Health System**, and other parties to whom **Palo Alto County Hospital, d/b/a Palo Alto County Health System**, may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of **Palo Alto County Hospital, d/b/a Palo Alto County Health System**, during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

A handwritten signature in cursive script that reads "Eide Sully LLP".

Minneapolis, Minnesota
July 20, 2006

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2006

Part I: Findings Related to the Financial Statements:

NONE

Part II: Other Findings Related to Required Statutory Reporting:

- II-A-06 Certified Budget – Health System disbursements during the year ended June 30, 2006, did not exceed amounts budgeted.
- II-B-06 Questionable Expenditures – We noted no expenditures that we believe would be in conflict with the requirements of public purpose as defined in an Attorney General’s opinion dated April 25, 1979.
- II-C-06 Travel Expense – No expenditures of Health System money for travel expenses of spouses of Health Center officials and/or employees were noted.
- II-D-06 Business Transactions – We noted no material business transactions between the Health System and Health System officials and/or employees.
- II-E-06 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-F-06 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa and the Health System’s investment policy were noted.
- II-G-06 Publication of Bills Allowed and Salaries – Chapter 347.13(14) of the Code of Iowa states “There shall be published quarterly in each of the official newspapers of the county as selected by the board of supervisors pursuant to section 349.1 the schedule of bills allowed and there shall be published annually in such newspapers the schedule of salaries paid by job classification and category...” The Hospital did publish a schedule of bills allowed and a schedule of salaries paid as required by the Code of Iowa.